The impact of the Welfare Benefits Uprating Bill

In December 2012, at the tail end of the parliamentary session, the government laid before the House of Commons a new piece of legislation. The Welfare Benefits Uprating Bill 2012 has a clear objective: to legitimate the Chancellor's decision in his Autumn Statement to uprate key in- and out-of-work benefits by just 1 per cent for the next three fiscal years. *Lindsay Judge* **explores the likely impacts of the Bill on the fortunes of children growing up in low-income families in the UK today, and subjects some of the rhetorical claims surrounding it to further scrutiny.**

IN THE AUTUMN STATEMENT of 2011, the Chancellor congratulated himself on resisting pressure to uprate benefits and tax credits at a rate lower than inflation. 'This will be a significant boost to the incomes of the poorest', he claimed, thereby ensuring that the most vulnerable in society were protected from the ravages of rising prices. A year on, he changed his mind: according to him, claimants have had it too good for too long, and it is now time they pulled their weight in helping fix the hole in the government's finances. As a result, he announced that most benefits and tax credits will be uprated by a fixed 1 per cent for the next three fiscal years, saving the government an estimated £3.7 billion a year in the process, and that he would seek parliamentary approval for the measure in the Welfare Benefits Uprating Bill.

The impact on living standards

As other commentators have pointed out, the real impact of the Bill is hard to fathom at this point, given that it depends on the way that inflation and average earnings change over the next three fiscal years.[1] Table 1 sets out the best guess we have: figures from the Office for Budget Responsibility (OBR) that are used by the Treasury for forward planning purposes, set against the levels at which key benefits are being uprated over the next three years as a result of government decisions.

As Table 1 shows, the Consumer Price Index (CPI) is projected to be between 2 and 2.5 per cent for the period 2013/14–2015/16. All other things being equal, a 1 per cent uprating of key benefits can only result in a fall in the real standard of living for anyone of working age who is reliant on the state for all or part of their income over the next three years. Calculations based on these OBR forecasts indicate that almost 4 per cent of the real value of the benefits affected will be wiped out by this measure over the three-year period, gains that are, of course, permanently locked in unless these benefits are subsequently over-indexed at some point in the future. In addition, for those benefits such as child benefit and key elements of working tax credit (WTC), the real, cumulative losses are greater with the sub-inflation uprating only serving to compound the effects of previous freezes to the real value.

However, the real losses that low-income families will sustain as a result of a sub-inflation indexation are likely to be underestimated in most analyses. We know that poorer households spend a larger proportion of their budgets on items such as food, fuel and water than wealthier households. As a consequence, when prices of these basics increase faster than general inflation, as they have in recent years, the effective rate of inflation for low-income households is higher than the headline CPI figure.[2] With the OBR continuing to forecast higher than average price growth for essentials such as fuel in the medium term, the losses low-income families will experience as a consequence of the 1 per cent uprating will be greater than any commentary using the average would suggest.[3]

The Bill will affect not just the absolute living standards of those who rely on working-age benefits to some degree, but also their relative position with respect to the rest of the population. Again, a look at Table 1 is instructive: with the Treasury anticipating average earnings growth for the whole economy of between 2.2 per cent and 3.9 per cent over the next three years, it is clear that the Bill will open up a gap between those who rely on the state for all or part of their incomes, and the rest of the population.

The Welfare Benefits Uprating Bill and child poverty

Declining living standards for those who rely on benefits for some or all of their income are assured, then, under the conditions set out in Table 1 and, of course, higher than projected inflation and average earnings would exaggerate this effect further. However, what does this mean for future child poverty rates?

Table 1: **Projected trends for prices, average earnings and key benefits, 2013/14–2015/16**

	2013/14 %	2014/15 %	2015/16 %
Consumer Price Index	2.5	2.2	2.0
Retail Prices Index	3.0	2.6	3.1
Average earnings	2.2	3.0	3.9
Working tax credit basic and 30-hour element	0.0	1.0	1.0
Child benefit	0.0	1.0	1.0
Child tax credit, jobseeker's allowance, income support, employment and support allowance	1.0	1.0	1.0
Local housing allowance	1.0	1.0	1.0
Universal credit disregards	1.0	1.0	1.0

Sources: CPI and RPI forecasts: Office for Budget Responsibility, *Economic and Fiscal Outlook December 2012*; average earnings: HM Treasury, *Autumn Statement*, December 2012, table B.2; benefit upratings: Welfare Benefits Uprating Bill 2012

The picture looked bleak enough according to the study produced by the Institute for Fiscal Studies (IFS) in October 2011 projecting child poverty rates for the UK over the next five to 10 years. According to this report, an estimated 400,000 more children will be living in relative poverty by the end of the current parliament, while the number living in absolute poverty looks set to increase by 500,000 over the same period. The IFS calculations take account of the multiplicity of tax and benefit changes announced by the government up to April 2011. Alongside this, the researchers also factored in the effect of universal credit (UC) as it was then envisaged, and in its fully implemented state.

Critically, in this study the IFS singled out the decision to index most working-age benefits to the CPI as opposed to the more generous retail prices index (RPI) from 2011 onwards as the most significant policy driving child poverty upwards in the next five to 10 years. But these projections do not now tell the full story. Since the IFS produced these alarming figures, the government has made other adjustments to the way it indexes benefits and tax credits which only worsen the prospect for low-income families. In 2011, for example, the Chancellor reneged on a previous promise to over-index child tax credit (CTC) and, at the same time froze the value of key elements of WTC. These subsequent changes will now be compounded by the decision to uprate most in- and out-of-work benefits, as well as key elements of UC, at a sub-inflation 1 per cent for three years.

The Bill will open up a gap between those who rely on the state for all or part of their incomes, and the rest of the population

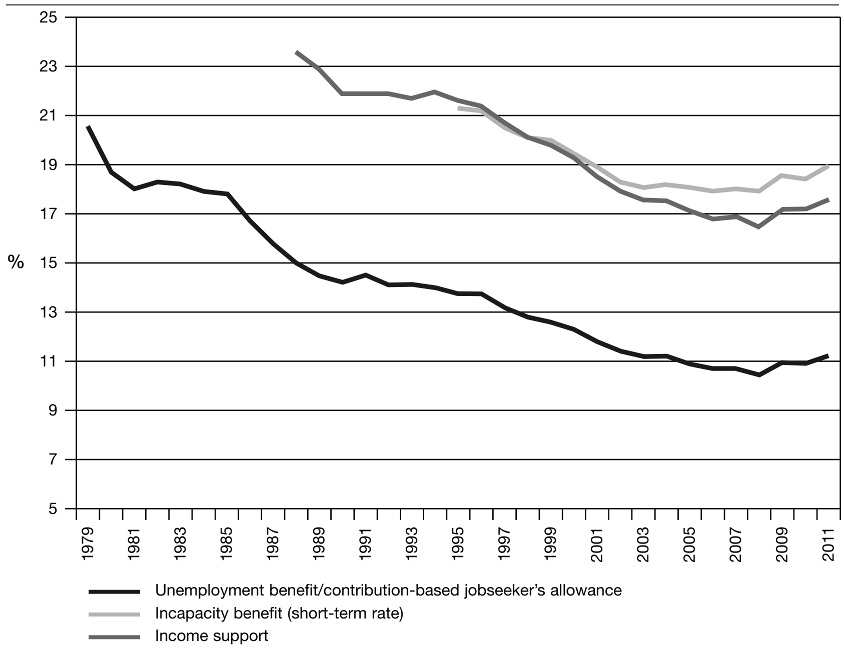
On the morning of the day the Bill received its second reading, the government finally published its *Impact Assessment* of the measure, only to say nothing about the likely impact of the Bill on child poverty rates.[4] A parliamentary question finally unearthed at least part of the picture, with the government estimating that 200,000 more children will be living in relative income poverty as a result of the uprating decision by 2015/16.[5]

Perhaps unsurprisingly, the government has yet to disclose figures on the effect the change will have on absolute poverty. Yet delinking benefits from prices will result in a fall in the real standard of living for anyone who is reliant on the state for all or part of their income over the next three years. As a consequence, in the absence of any compensatory changes, the number of children living in absolute poverty can only rise, while those children in families reliant on out-of-work benefits who already live below this threshold will see their poverty deepen further.

Mitigating measures?

The government has two stock responses when asked about the negative impacts on low-income families of any measure it introduces: that UC, once introduced, will 'fix' the problems of the benefit system by making work pay, and that the incremental increases being made to the personal tax allowance provide compensatory benefits that offset any other losses that low-income families are experiencing. How true are these claims?

Figure 1: **Value of key out-of-work benefits as a % of GDP, 1979–2011**



Source: *Abstract of Statistics for Benefits, NI and Contributions, and Indices of Prices and Earnings*, Department for Work and Pensions, 2011

The government's response to the same parliamentary question makes clear that the anticipated poverty-reducing impact of UC will be dampened by the fact that it, too, will be uprated at 1 per cent for the next three years. In its October 2011 *Impact Assessment*, the government had claimed that UC would reduce child poverty by at least 350,000, and that the dynamic effects of the new benefit would compound this reduction further.[6] However, in its response to the parliamentary question, the government has had to revise down its estimate to 150,000, although claims about the behavioural effects of UC are still rife.

Neither will the changes being made to the personal tax allowance offset the shortfalls families will face as a result of the sub-inflation uprating. Extending the threshold potentially leaves basic rate taxpayers £47 better off in 2013/14. But those who are not in work and those who do not earn enough to reach the threshold gain no benefit whatsoever from its extension. In addition, low-income working families who do earn beyond this point will see much of the gain evaporate as other forms of support are tapered away in response to their higher post-tax income. While those further up the income scale will keep the full amount, a working family eligible for both housing and council tax benefit will net only £7 extra a year as a result of extended allowances.

Is the Bill 'fair'?

Despite the fact that the Uprating Bill will depress both the real and relative living standards of those at the bottom of the income distribution, as well as drive up child poverty, it is being presented by the government as 'fair' on two grounds. First, the government has pitted the idea of a hard-working low-income family against those who 'enjoy' a life on out-of-work benefits, suggesting that the latter is doing better at the expense of the former.[7] Second, it claims that a 1 per cent uprating is a generous gesture, given that benefits have risen at a faster rate than average earnings for the last five years.

In fact, the 'skivers and strivers' trope proved so far removed from reality that the government was forced to retreat somewhat from its original framing of the uprating measure. Analysis from the Resolution Foundation shows, for example, that, in truth, 60 per cent of the cuts stemming from the Welfare Benefits Uprating Bill will fall on those who were in rather than out of work.[8] Likewise, work for CPAG illustrates that the vast majority who claim out-of-work benefits have worked and are likely to work again in the near future, blurring the categories between in- and out-of-work claimants.[9]

Nor is it clear where the equity is in pegging benefits to 1 per cent public sector pay rises when, as Table 1 shows, average earnings growth for the whole economy is projected to be between 2.2 per cent and 3.9 per cent over the next three years. And again, the average obscures the experience of those on low incomes: Office for National Statistics data show, for example, that between 2009/10 and 2010/11, the earnings of those in the lowest three income quintiles either decreased or increased at a slower rate than the average, while those in the top two income quintiles saw their earnings rise significantly, with those in the fourth quintile seeing a 6.1 per cent increase in their earnings, and those in the fifth quintile seeing a 3.2 per cent increase.[10]

Finally, what has been conveniently obscured in the debate about uprating is the fact that, for many years prior to 2008, benefits rose at a significantly lower level than wages. As salaries raced ahead before the recession, a stark gap opened up between earnings and benefits. As Figure 1 shows, the value of unemployment benefit (and its successor, jobseeker's allowance) fell, for example, from over 20 per cent of average earnings in 1979 to just over 11 per cent by 2011, while other out-of-work benefits have drifted down at a similar rate.

Conclusion

Looking at this historical picture should make us all pause for thought. In fact, the above-average earnings upratings of the last five years have had limited effect on the relative value of benefits eroded over a long period of time, showing how difficult it is to correct the damage done by year after year of under-indexation. Alongside this, it is worth recalling that the decision to decouple benefit levels from wages is widely recognised as the most significant policy that drove the dramatic increases in relative child poverty through the 1980s and 1990s.[11]

Given this, the Uprating Bill risks history repeating itself, with one significant difference. This time round we are likely to witness significant rises in child poverty against the backdrop of the Child Poverty Act 2010, a law which requires the government to concern itself with both the absolute and the comparative fortunes of children growing up in the UK today, and to take action to reduce absolute poverty to below 5 per cent, and relative child poverty to below 10 per cent, by 2020.

Yet three years of benefit uprating that is linked to neither prices nor average earnings will deliberately lock in both real and relative losses for low-income families, at the same time as locking them out of the mainstream. In truth, it will be impossible to square the true consequences of the Uprating Bill with the government's obligations under the Child Poverty Act. But whether the government succeeds in winning the false, rhetorical arguments which characterise this policy will depend, in large part, to the scrutiny to which it is subjected. ■

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1 Institute for Fiscal Studies, *The Effects of the Welfare Benefits Uprating Bill*, 2013, available at www.ifs.org.uk/publications/6539
2 P Levell and Z Oldfield, *The Spending Patterns and Inflation Experience of Low-income Households Over the Past Decade*, Institute for Fiscal Studies, 2011; Department for Work and Pensions, *Universal Credit Impact Assessment*, 2012, available at www.dwp.gov.uk/docs/universal-credit-wr2011-ia.pdf
3 Office for Budget Responsibility, *Economic and Fiscal Outlook*, CM 8481 2012, p75
4 Department for Work and Pensions, *Universal Credit Impact Assessment*, October 2011
5 House of Commons, *Hansard*, Written Answers, 15 January 2013, col 715W
6 Department for Work and Pensions, *Universal Credit Impact Assessment*, 2011
7 See, for example, Steve Webb Minister of State (Pensions) in House of Commons debate, *Hansard*, 6 December 2012, col 1030
8 M Whitaker, *Resolution Foundation Analysis of the Autumn Statement*, Resolution Foundation, 2012
9 D Gaffney in *The Double Lockout: how low-income families will be locked out of fair living standards*, CPAG, 2013
10 Office for National Statistics, *Average Weekly Earnings,* 2012. The precise figures are as follows: 1st quintile 1.4 per cent, 2nd quintile -3.1 per cent, 3rd quintile -0.2 per cent, 4th quintile 6.1per cent, 5th quintile 3.2 per cent.
11 J Hills, 'The Last Quarter Century: from New Right to New Labour', in H Glennerster and others, *One Hundred Years of Poverty and Policy*, Joseph Rowntree Foundation, 2004